

2. Energy Efficient Windows or Doors for the outside of the facility, including insulating shades and shutters.
3. Caulking or Weather stripping for windows or doors for the outside of the facility.
4. Fans specially designed for circulation of heat inside the building.
5. Wood and Coal burning furnaces or boilers (not fireplaces).
6. Furnace Replacement burners that reduce the amount of fuel used.
7. Enetrol or other devices connected to furnaces to control heat usage.
8. A Device or Capital Expenditures for modifying an existing furnace that reduces the consumption of fuel.
9. Solar active systems for water and space heating.
10. Retrofitting structures for the purpose of creating or enhancing passive solar gain, if prior approved by the Department regardless of amount of expenditure. A request for prior approval will be evaluated by the Department on the basis of whether energy costs would be decreased to such an extent as to render the expenditure reasonable. The age and condition of the facility requesting approval will be also considered.
11. Any other energy saving devices that might qualify as Energy Efficient other than those listed above must be prior approved by the Department for this Special Reimbursement provision. The Department will evaluate a request for prior approval under recommendations from the Division of Energy Programs on what other items will qualify as an energy efficient device and that the energy savings device is a reliable product and the device would decrease the energy costs of the facility making the expenditure reasonable in nature.

44.24.5 In the event of a sale of the facility the principle payments as listed above will be recaptured in lieu of depreciation.

TN# 92-13
Supersedes
TN# 91-12

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44.25 Recording of depreciation. Appropriate recording of depreciation encompasses the identification of the depreciable assets in use, the assets' historical costs, the method of depreciation, estimated useful lives, and the assets' accumulated depreciation. The American Hospital Association's "Estimated Useful Lives of Depreciable Hospital Assets" is to be used as a guide for the estimation of the useful life of assets.

44.25.1 For new buildings constructed after April 1, 1980 the minimum useful life to be assigned is listed below:

Wood Frame, Wood Exterior	30 years
Wood Frame, Masonry Exterior	35 years
Steel Frame, or Reinforced Concrete Masonry Exterior	40 years

If a mortgage obtained on the property exceeds the minimum life as listed above, then the terms of the mortgage will be used as the minimum useful life.

44.26 Depreciation method. Proration of the cost of an asset over its useful life is allowed on the straight-line method.

44.27 Funding of depreciation. Although funding of depreciation is not required, it is strongly recommended that providers use this mechanism as a means of conserving funds for replacement of depreciation assets, and coordinate their planning of capital expenditures with area wide planning of activities of community and state agencies. As an incentive for funding, investment income on funded depreciation will not be treated as a reduction of allowable interest expense.

44.28 Replacement reserves. Some lending institutions require funds to be set aside periodically for replacement of fixed assets. The periodic amounts set aside for this purpose are not allowable costs in the period expended, but will be allowed when withdrawn and utilized either through depreciation or expense after considering the usage of these funds. Since the replacement reserves are essentially the same as funded depreciation the same regulations regarding interest and equity will apply.

44.28.1 If a facility is leased from an unrelated party and the ownership of the reserve rests with the lessor, then the replacement reserve payment becomes part of the lease payment and is considered an allowable cost in the year expended. If for any reason the lessee is allowed to use this replacement reserve for the replacement of the lessee's assets then during that year the allowable lease payment will be reduced by that amount. The Lessee will be allowed to depreciate the assets purchased in this situation.

TN# 92-13
Supersedes
TN# 91-12

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44.28.2 If a rebate of a replacement reserve is returned to the lessee for any reason, it will be treated as a reduction of the allowable lease expense in the year review.

44.29 Gains and Losses on disposal of assets. Gains and losses realized from the disposal of depreciable assets are to be included in the determination of allowable costs. The extent to which such gains and losses are includable is calculated on a proration basis recognizing the amount of depreciation charged under the program in relation to the amount of depreciation, if any, charged or assumed in a period prior to the provider's participation in the program, and in the period after the provider's participation in the program when the sale takes place within one year after termination.

44.29.1 The recapture will be made in cash from the seller. During the first eight years of operation, all depreciation allowed on buildings and fixed equipment by the Department will be recaptured from the seller in cash at the time of the sale. From the 9th to the 15th year all but 3% per year will be recaptured and from the 16th to the 25th year, all but 8% per year will be recaptured, not to exceed 100%. Accumulated depreciation is recaptured to the extent of the gain on the sale. Unless there is a sales agreement specifically detailing each piece of moveable equipment included in the sale, the gain on the sale of moveable equipment will be determined by the total selling price of the equipment. No credits are allowed on moveable equipment.

44.210 Limitation on the participation of capital expenditures. Depreciation and interest are not allowable with respect to any capital expenditure in plant and property, and equipment related to patient care, which has not been submitted to the designated planning agency as required, or has been determined to be consistent with health facility planning requirements.

44.3 Purchase, Rental, Donation and Lease of Capital Assets

44.3.1 Purchase of facilities from related individuals and/or organization Where a facility, through purchase, converts from a proprietary to a nonprofit status and the buyer and seller are entities related by common and/or ownership, the purchaser's basis for depreciation shall not exceed the seller's basis under the program, less accumulated depreciation if the following requirements are met:

44.3.1.1 A) Where a facility is purchased from an individual or organization related to the purchaser by common control and/or ownership; or

B) Where a facility is purchased after April 1, 1980 by an individual related to the seller as:

TN# 92-13
Supersedes
TN# 91-12

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- (1) a child
- (2) a grandchild
- (3) a brother or sister
- (4) a spouse of a child, grandchild, or brother or sister, or
- (5) an entity controlled by a child, grandchild, brother, sister or spouse of child, grandchild or combination brother or sister thereof; or

44.3.1.2 Accumulated depreciation of the seller under the program shall be considered as incurred by the purchaser for purposes of computing gains and applying the depreciation recapture rules Subsection 44.29 to subsequent sales by the buyer. There will be no recapture of depreciation from the seller on a sale between stipulated related parties since no set-up in the basis of depreciable assets is permitted to the buyer.

44.3.1.3 ~~One-time~~ exception to subsection 44.3.1.2 At the election of the seller, subsection 44.3.1.1 will not apply to a sale made to a buyer defined in subsection 44.3.1.2 if:

- (a) the seller is an individual or any entity owned or controlled by individuals or related individuals who were selling assets to a "related party" as defined in subsection 44.3.1.1 or 44.3.1.2.
- (b) the seller has attained the age of 55 before the date of such sale or exchange; and
- (c) during the twenty-year period ending on the day of the sale, the seller has owned and operated the facility for periods aggregating ten years or more; and
- (d) the seller has inherited the facility as property of a deceased spouse to satisfy the holding requirements under subsection 44.3.1.3c
- (e) if the seller makes a valid election to be exempted from the application of 44.3.1.2 the allowable basis of depreciable assets for reimbursement of interest and depreciation expense to the buyer will be determined in accordance with the historical cost as though the parties were not related. This transaction is subject to depreciation recapture if there is a gain on the sale.

44.3.1.4 The one exception to subsection 44.3.1.2 applies to individual owners and not to each facility. If an individual owns more than one facility he must make the election as to which facility he wished to apply this exception to.

44.3.1.5 Limitation in the application of subsection 44.3.1.3

44.3.1.5.1 Subsection 44.3.1.3 shall not apply to any sale or exchange by the seller if an election by the seller under subsection 44.3.1.3 with respect to any other sale or exchange has taken place.

44.3.1.5.2 Subsection 44.3.1.3 shall not apply to any sale or exchange by the seller unless the seller:

44.3.1.5.2.1 immediately after the sale has no interest in the nursing home (including an interest as officer, director, manager or employee) other than as a creditor, and

44.3.1.5.2.2 does not acquire any such interest within 10 years after the sale of this or any other facility and

44.3.1.5.2.3 agrees to file an agreement with the Department of Human Services to notify the Department that any acquisition as defined by the subsection 44.3.1.5.2.2 has occurred.

44.3.1.6 If subsection 44.3.1.5.2 is satisfied, subsection 44.3.1.1 and subsection 44.3.1.2 will also be satisfied.

44.3.1.7 If the seller acquires any interest defined by subsection 44.3.1.5.2.2, then pursuant to the agreement the basis will revert to what the seller's basis would be if the seller had continued to own the facility, the amounts paid by the Title XIX program for depreciation, interest and return of owner's equity from the increase in basis will be immediately recaptured, and an interest rate of nine percent per annum on recaptured monies will be paid to the Department for sellers' use of Title XIX monies. A credit against this, of the original amount of depreciation recapture from the seller, will be allowed, with any remaining amount of the original depreciation recapture becoming the property of the Department.

44.3.2 Basis of assets used under the program and donated to a provider. Where an asset that has been used or depreciated under the program is donated to a provider, the basis of

depreciation for the asset shall be the lesser of the fair market value or the net book value of the asset in the hands of the owner last participating in the program. The net book value of the asset is defined as the depreciable basis used under the program by the asset's last participating owner less the depreciation recognized under the program.

44.3.3 Allowances for depreciation on assets financed with Federal or Public Funds. Depreciation is allowed on assets financed with Hill Burton or other Federal or Public Funds.

44.4 LEASES AND OPERATIONS OF LIMITED PARTNERSHIPS

44.4.1 Information and Agreements Required for Leases. If a provider wishes to have costs associated with leases included in reimbursement:

44.4.1.1 A copy of the signed lease agreement is required.

44.4.1.2 An annual copy of the federal income tax return of the lessee will be made available to representatives of the Department and of the U.S. Department of Health and Human Services in accordance with section 27 2050.

44.4.1.3 If the lease is for the use of a building and/or fixed equipment, the articles and bylaws of the corporation, trust indenture partnership agreement, or limited partnership agreement of the lessor is required.

44.4.1.4 If the lease is for the use of a building and/or fixed equipment, the annual federal income tax return of the lessor will be made available to representatives of the Department and the U.S. Department of Health and Human Services in accordance with section 27.

44.4.1.5 A copy of the mortgage or other debt instrument of the lessor will be made available to representatives of the Department and the U.S. Department of Health and Human Services. The lessor will furnish the Department of Human Services a copy of the bank computer printout sheet on the lessor's mortgage showing the monthly principle and interest payments.

44.4.1.6 The lease must be for a minimum period of 25 years if an unrelated organization is involved. If the lease should include an option to purchase which is exercised by the lessee, then the portion of the lease payment made in lieu of straight line depreciation will be recaptured in accordance with subsection 44.29.

44.4.2 Lease Arrangements Between Individuals or Organizations Related by Common Control and/or Ownership. A provider may lease a

TN# 92-13
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TN# 91-12

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facility from a related organization within the meaning of the Principles of Reimbursement. In such case, the rent paid to the lessor by the provider is not allowed as a cost. The provider, however, would include in its costs the costs of ownership of the facility. Generally, these would be costs of the lessor such as depreciation, interest on the mortgage, real estate taxes and other expenses attributable to the leased facility. The effect is to treat the facility as though it were owned by the provider.

44.4.3 Leased Arrangement Between Individuals or Organizations Not Related by Common Control or Ownership. A provider may lease a facility from an unrelated organization within the meaning of the Principles of Reimbursement. The allowable cost between two unrelated organizations is the lesser of:

44.4.3.1 The actual costs calculated under the assumption that the lessee and the lessor are related parties; or

44.4.3.2 The actual lease payments made by the lessee to the lessor.

44.4.3.3 The above principle applies unless the lessor refinances and reduces the cost of ownership below the cost of lease payments and the lessee remains legally obligated to make the same lease payment despite the refinancing. This limitation of the general rule shall not apply to any lease entered into, renewed, or renegotiated after January 1, 1990. If this limitation applies, the allowable cost shall be the actual lease payments made by the lessee to the lessor.

44.4.3.4 If the cost as defined in subsection 44.332 are less than the costs as defined in subsection 44.331, then the difference can be deferred to a subsequent fiscal period. If in a later fiscal period, costs as defined in section 44.332 exceed costs as defined in section 44.331, the deferred costs may begin to be amortized. Amortization will increase allowable costs up to the level of the actual lease payments for any given year. These deferred costs are not assets of the provider for purposes of calculating allowable costs of interest or return of owners equity and, except as specified, do not represent assets that a provider or creditor of a provider may claim is a monetary obligation from the Title XIX program.

44.4.3.5 A Lease payment to an unrelated party for moveable furnishings and equipment is an allowable cost, but it shall be limited to the cost of ownership.

44.4.4 Sale and Leaseback Agreements-Rental Charges. Rental costs specified in sale and leaseback agreements incurred by providers through selling physical plant facilities or equipment to a purchaser not connected with or related to the provider, and

concurrently leasing back the same facilities or equipment, are includable in allowable cost.

However, the rental charge cannot exceed the amount which the provider would have included in reimbursable costs, had he retained legal title to the facilities or equipment, such as interest on mortgage, taxes, depreciation, insurance and maintenance costs.

44.5 Interest Expense

44.5.1 Principle. Necessary and proper interest on both current and capital indebtedness is an allowable cost.

44.5.2 Interest. Interest is the cost incurred for the use of borrowed funds. Interest on current indebtedness is the costs incurred for funds borrowed for a relatively short term, usually one (1) year or less, but in no event more than fifteen (15) months. This is usually for such purposes as working capital for normal operating expenses. Interest on capital indebtedness is the cost incurred for funds borrowed for capital purposes, such as acquisition of facilities and equipment, and capital improvements. Generally, loans for capital purposes are long-term loans. Except as provided in subsection, interest does not include interest and penalties charged for failure to pay accounts when due.

44.5.3 Necessary. In order to be considered "necessary", interest must:

44.5.3.1 Be incurred on a loan made to satisfy a financial need of the provider. Loans which result in excess funds or investments would be considered unnecessary; and

44.5.3.2 Be reduced by investment income except where such income is from gifts, whether restricted or unrestricted, and which are held separate and not commingled with other funds. Income from funded depreciation is not used to reduce interest expense.

44.5.3.3 Proper. Proper requires that interest:

44.5.3.3.1 Be incurred at a rate not in excess of what a prudent borrower would have had to pay in the money market existing at the time the loan was made.

44.5.3.3.2 Be paid to a lender not related through control or ownership, or personal relationship to the borrowing organization.

44.5.3.4 Refinancing. Any refinancing of property mortgages or loans on fixed assets must be prior approved by the Department. If prior approval is not obtained any

additional interest costs or finance charges will not be allowed.

44.5.4 Borrower-lender relationship

44.5.4.1 To be allowable, interest expense must be incurred on indebtedness established with lenders or lending organizations not related through control, ownership or personal relationship to the borrower. Presence of any of these factors could affect the "bargaining" process that usually accompanies the making of a loan, and could thus be suggestive of an agreement with higher rates of interest or of unnecessary loans. Loans should be made under terms and conditions that a prudent borrower would make in arm's-length transactions with lending institutions. The intent of this provision is to assure that loans are legitimate and needed, and that the interest rate is reasonable. Thus, interest paid by the provider to partners, stockholders, or related organizations of the provider would not be allowed. However, interest on first or second mortgages held by stockholders, owners, relatives or related organizations of the provider, will be treated as an allowable cost if it is in line with the interest rates charged by lending institutions at the inception of the loan. Where the owner uses his own funds in a business, it is reasonable to treat the funds as invested funds or capital, rather than borrowed funds. Therefore, where interest on loans by partners, stockholders, or related organizations is disallowed as a cost solely because of the relationship factor, the principal of such loans shall be treated as invested funds in the computation of the provider's equity capital.

44.5.4.2 Exceptions to the general rule regarding interest on loans from controlled sources of funds. Where the general fund of a provider borrows from a donor-restricted fund and pays interest to the restricted fund, this interest expense is an allowable cost. The same treatment is accorded interest paid by the general fund on money borrowed from the funded depreciation account of the provider. In addition, if a provider of a facility operated by members of a religious order borrows from the order, interest paid to the order is an allowable cost. Interest paid by the provider cannot exceed interest earned by the above subject funds.

44.5.4.3 Where funded depreciation is used for purposes other than improvement, replacement, or expansion of facilities or equipment related to patient care, or payment of long-term debt principle once the principle payment exceeds the straight-line depreciation allowed under the Principles of Reimbursement, allowable interest expense is reduced to adjust for offsets not made in prior years for earnings on funded depreciation.

44.5.4.4 Loans not reasonably related to patient care. Loans made to finance that portion of the cost of acquisition of a facility that exceeds historical cost are not considered to be for a purpose reasonably related to patient care.

44.5.4.5 Interest expense of related organizations. Where a provider leases facilities from a related organization and the rental expense paid to related organization is not allowable as a cost, costs of ownership of the leased facility are allowable as in interest cost to the provider. Therefore, in such cases, mortgage interest paid by the related organization is allowable as an interest cost to the provider.

44.5.4.6 Interest on Property Taxes. Interest charged by a municipality for late payment of property taxes is an allowable cost when the following conditions have been met:

44.5.4.6.1 The rate of interest charged by the municipality is less than the interest which a prudent borrower would have had to pay in the money market existing at the time the loan was made;

44.5.4.6.2 The payment of property taxes is deferred under an arrangement acceptable to the municipality;

44.5.4.6.3 The late payment of property taxes results from the financial needs of the provider and does not result in excess funds; and

44.5.4.6.4 Approval in writing has been given by the Department prior to the time period in which the interest is incurred. Any requests for prior approval must be received by the Department at least two weeks prior to the desired effective date of the approval.

44.5.4.7 Limitation on the participation of capital expenditures. Interest is not allowable with respect to any capital expenditure in plant, and property, and equipment related to patient care, which did not receive a required Certificate of Need Review approval.

44.6 Return on Equity Capital of Proprietary Providers

44.6.1 Principle. A reasonable return on equity capital invested and used in the provision of patient care is allowable as an element of the reasonable cost of covered services furnished to the beneficiaries by proprietary providers. The amount on an annual basis is eight percent (8%).